No. 82-1142

IN THE

Supreme Court of the United States

OCTOBER TERM 1982

SHARON STEEL CORPORATION, et al.,

Petitioners,

—v.—

THE CHASE MANHATTAN BANK, N.A., et al.,

Respondents.

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioners Sharon Steel Corporation ("Sharon Steel"), UV Industries, Inc., and the Trustees of the UV Industries, Inc. Liquidating Trust (collectively, "UV") submit this brief in support of their petition for a writ of certiorari and in reply to the brief in opposition submitted by the respondent Indenture Trustees and Intervenors.

In opposing the petition, the respondents attempt to dismiss the Second Circuit's decision as one of little import which simply involves the application of state contract principles. The Second Circuit's decision does not, in fact, support this description. By interspersing excerpts from the district court's opinion with the language of the Second Circuit's decision,

and by taking certain aspects of that decision out of context, the respondents have molded a new decision to fit their theory of opposition.

On the basis of this hybrid, the respondents have advanced three primary points of opposition to the petition: (1) they attempt to distinguish the Second Circuit's decision in the present action from the Fifth Circuit's decision in *Broad v. Rockwell International Corp.*, 642 F.2d 929 (5th Cir.) (in banc), *cert. denied*, 454 U.S. 965 (1981) (hereinafter "*Broad v. Rockwell*"); (2) they contend that the Second Circuit's decision only concerns state law and is limited by the purported uniqueness of the facts involved and therefore will have no effect on the course of future indenture controversies; and (3) they contend that the Second Circuit's decision was necessary to avoid leaving the debtholders without any protection. Each of these points of opposition is without merit.

1. The Conflict Between the Second and Fifth Circuits Cannot Be Distinguished Away

The respondents implicitly acknowledge that the Second Circuit's decision and *Broad v. Rockwell* embody different approaches to the application of indenture provisions, with inevitably different results. They argue, however, that these decisions can be distinguished, and that therefore no true conflict is present for this Court to resolve. The distinction is alleged to inhere in the presence or absence of ambiguity in the indenture provisions treated by the two circuit courts.

Supposedly, the indenture provisions reviewed by the Second Circuit were ambiguous, and therefore allegedly "unique factual circumstances" involving the particular parties to the action justified the Second Circuit's unorthodox implication of asset sale restrictions not explicitly contained in the indentures. The respondents contend that, in contrast, the *Broad v. Rockwell* indenture was unambiguous and had a "plain meaning" which could not be ignored by the implication of additional rights.

It is noteworthy to say the least that the respondents should now seek refuge in the concept of ambiguity inasmuch as they argued to the Second Circuit that "the Indentures unambiguously require that the 'all or substantially all' test be applied against property owned by UV on the date its liquidation plan commenced. . . ." Appellees' Brief at 41.

The proffered "ambiguity" distinction is misconceived. The Second Circuit's opinion nowhere even implies, much less asserts, that the indenture provision in question is ambiguous. It was not because of any perceived ambiguity that the Second Circuit rejected "a literal reading" as "not helpful." 691 F.2d at 1049; Pet. App. A at 22a.[1]

Both the Second and Fifth Circuits take the position that the application of boilerplate indenture provisions is a matter of law and that factual idiosyncracies in the relations of particular parties should not alter the uniform meaning of such boilerplate provisions. Indeed, the Second Circuit explicitly purported to reject the notion that unique extrinsic facts should alter the meaning of boilerplate indenture provisions:

> "Boilerplate provisions are thus not the consequence of the relationship of particular borrowers and lenders and do not depend upon particularized intentions of the parties to an indenture. There are no adjudicative facts relating to the parties to the litigation for a jury to find, and the meaning of boilerplate provisions is, therefore, a matter of law rather than fact." 691 F.2d at 1048; Pet. App. A at 18a-19a.

Not only did both circuit courts interpret the respective indentures as a matter of law, but both courts were able to

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1 The respondents strain to attach significance to the district court's statement at an earlier stage in the proceedings that the indenture provision in question is "not wholly unambiguous." Brief in Opp. at 6. Not only is this statement irrelevant to the Second Circuit opinion, but the district court itself ultimately decided to take the case away from the jury and to resolve the indenture question as a matter of law. 521 F. Supp. at 113; Pet. App. B at 47a.

determine a plain, or literal, meaning from the face of the indenture language in issue. It is at that point, however, that the direct conflict between the two courts emerges.

The Fifth Circuit identified the literal meaning of the language of the indenture before it and adhered to that meaning, 642 F.2d at 948-55; the Second Circuit identified the literal meaning of the indenture provision before it, acknowledged that it was the meaning advanced by Sharon Steel, 691 F.2d at 1049; Pet. App. A at 21a, but then jettisoned it in favor of a policy analysis that implied rights and obligations that were never included in the indentures, 691 F.2d at 1049-51; Pet. App. A at 21a-26a. The conflict is clear and indisputable, and cannot be distinguished away.[2]

It is quite remarkable for the respondents to assert that "the Second Circuit expressly acknowledged the teaching of *Broad v. Rockwell Int'l Corp.* regarding the interpretation of indentures and avowed its intention to follow that teaching." Brief in Opp. at 6. The fact is that the Second Circuit referred to *Broad v. Rockwell* solely for the proposition that "uniformity in interpretation is important to the efficiency of capital

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2 In the petition, the petitioners referred to *Pittsburgh Terminal Corp. v. Baltimore & Ohio Railroad Co.*, 680 F.2d 933 (3d Cir.), *cert. denied*, 103 S.Ct. 476 (1982), and both the 3-judge panel and in banc decisions in *Broad v. Rockwell*, as examples of the conflict and disagreement that are engendered by departure from the traditional rule of not implying terms into indentures. In response, respondents offer mere conclusionary statements that no conflict is suggested by those cases. They do not, and cannot, explain away the fact that the two Third Circuit judges who addressed the indenture issue in *Pittsburgh Terminal* reached directly opposite conclusions caused by one judge's reliance on Second Circuit precedent and the other's reliance on *Broad v. Rockwell*. *Compare Pittsburgh Terminal*, *supra*, 680 F.2d at 941, *with* 680 F.2d at 951-52. Similarly, the respondents cannot avoid the fact that in *Broad v. Rockwell*, the Fifth Circuit sitting in banc and applying traditional indenture law reached a decision different from that of the *Broad v. Rockwell* panel which relied on Second Circuit precedent. *Compare Broad v. Rockwell International Corp.*, 614 F.2d 418, 429-30 (5th Cir. 1980) (panel decision), *with Broad v. Rockwell*, *supra*, 642 F.2d at 957-58 (in banc decision).

markets." 691 F.2d at 1048; Pet. App. A at 19a. The Second Circuit in no way, shape, or form acknowledged the teaching of *Broad v. Rockwell* that indenture language is to be read literally, and nowhere in the Second Circuit's opinion is there any avowal of an intention to follow that rule.

The inescapable fact is that one cannot put the two opinions side by side and avoid the conclusion that they conflict because they proceed from fundamentally different conceptions about the role of courts in resolving disputes concerning indenture provisions. The Fifth Circuit follows the tradition of conceiving that role as a narrow one—a tradition largely responsible for the notable self-regulation and relative dearth of litigation in this area of the law. The Second Circuit conceives that role as a broad one. That conception, which impatiently glosses over the literal meaning of indenture language in favor of an analysis of underlying policies and interests, will inevitably breed litigation.

2. The Principle of the Second Circuit's Decision Transcends State Law and Is Not Limited by the Alleged Uniqueness of This Case.

The respondents argue that the Second Circuit's decision depends on peculiarities of state law and on unique circumstances which limit its effect to the case at hand. This argument ignores the expansive language and substance of Judge Winter's opinion.

The opinion nowhere relies on the pecularities of any particular state's law to justify its unprecedented implication of substantive rights. It relies on concepts that transcend state boundaries. It consciously crafts a result intended for national application.

Likewise, the instruments which lie at the center of the present dispute bind persons and entities throughout the country and govern rights and obligations relating to securities traded nationally. To suggest that the present controversy "involves nothing more than an interpretation under state law," Brief in Opp. at 5, blinks reality.

Even if the Second Circuit's decision could somehow be limited to controversies specifically involving successor obligor provisions, its reach would remain considerable. After all, as the Second Circuit itself recognized, 691 F.2d at 1048; Pet. App. A at 18a, such provisions are contained in virtually all corporate trust indentures. Moreover, the Second Circuit's rationale would likely be applied to any type of corporate reorganization or series of asset dispositions. It is ironic that the respondents now contend that the Second Circuit's decision will be limited to only those controversies involving precisely the same circumstances presented in this action: in the proceedings below they argued that their suggested meaning of the Indentures (which the Second Circuit adopted) should be applicable to various types of reorganizations, whether formal or informal. *See, e.g.*, Appellees' Brief at 30, 36, 38-39.

Moreover, the implications of the Second Circuit's decision are broadened, not narrowed, by the reliance on "unique factual circumstances." Prior to the Second Circuit's decision it was accepted that the substantive rights and obligations of parties to an indenture are set by the instrument's explicit language and do not depend on the exigencies of particular factual circumstances. The whole course of indenture law has been toward standardization of expression and interpretation. Thus, in 1939, Congress enacted the Trust Indenture Act to impose uniform obligations on indenture trustees, and in the 1960's and early 1970's, the American Bar Foundation's *Sample Incorporating Indenture and Model Debenture Indenture Provisions* (1965) and *Commentaries on Model Indenture Provisions* (1971) were promulgated to further standardize other common indenture provisions.

The Second Circuit's decision departs irreconcilably from the thrust of indenture law. The decision advances the proposition that the uniform meaning of standardized indenture provisions can no longer be ascertained from the explicit language employed, but rather must be determined individually from each unique set of factual circumstances. By this approach, indenture language will be like a chameleon, changing color

and meaning depending on its surroundings. If the Second Circuit's decision is allowed to stand, the parties who must turn to indentures to "adjust their affairs," 691 F.2d at 1048; Pet. App. A at 19a, will no longer be able to rely on the clear and standardized language of indenture provisions. Instead, the course of indenture law will be diverted to a burdensome case-by-case analysis that is anathema to the national uniformity required in this crucial area of corporate finance.

3. The "Infinitesimal" Scenario Is Inapposite

In attempting to defend the Second Circuit's approach of not giving indenture provisions their literal meaning, the respondents reach back to a passage in the district court's opinion. Brief in Opp. at 7. In that passage, Judge Werker expressed concern about the possibility that under a literal reading of the successor obligor provisions, an obligor could sell all its assets in a series of transactions and then sell an "infinitesimal" amount of remaining assets to another corporation which would purport to assume the debt. 521 F. Supp. at 114; Pet. App. B at 48a-49a. While giving it less emphasis than the district court, the Second Circuit also seemed concerned about this possibility. 691 F.2d at 1051; Pet. App. A at 25a-26a.

These concerns are an overreaction to a hypothetical situation that could not have arisen in this case, that is unlikely to arise, and that, if it ever arose, could be fully dealt with by legal mechanisms already in place to handle such situations. At bottom, these concerns are grounded on the assumption that, short of treating the successor obligor provisions as including implied asset sale restrictions, there is no bulwark against the "infinitesimal" scenario. That assumption is wrong, both in the context of this case and in general.

In the instant case, the dividend restriction in the Indenture covering the senior and largest issue of debt clearly protected the debtholders from the hypothetical worst case which concerned the courts below. That was the protection that was bargained for; that is the protection that was explicitly in-

cluded. It guaranteed the debtholders that regardless of how many distributions or asset sales occurred over time, the distributions could not have the effect of reducing the corporation's assets significantly below the level that existed when the Debentures were issued. No less was relied on when the debt obligations were incurred, but no more could be relied on when those same obligations were assumed.[3] In short, UV could not under these Indentures voluntarily reduce it assets to an "infinitesimal" amount.

Restrictions such as this dividend restriction are common and provide all the protection that is needed against the hypothetical situations envisioned by the courts below. *See* American Bar Foundation, *Commentaries on Model Indenture Provisions* (1971) at 402. But let us assume a situation where no such dividend restriction exists. Even then, the infinitesimal scenario is a red herring. If a corporation sells 99% of its assets, distributes the proceeds, and then seeks to sell the remaining 1% to another buyer who would assume its debt, would the debtholders be without protection as the courts below apparently feared? Obviously, it is totally unrealistic to assume that any buyer would want to assume $100,000,000 of debt if he is purchasing only, say, $1,000,000 in assets. If such a transaction did occur, however, it would be a sham or fraudulent transaction, in which event debtholders would remain safeguarded by a whole panoply of laws that protect credi-

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3 As at least one of the respondent Intervenors admitted quite candidly in an internal memorandum dated after the sale of Federal and after the sale of the oil and gas properties was announced, the dividend restriction was sufficient to safeguard its rights during UV's liquidation:

> "Importantly, Section 4.08 of the indenture under which the 8 7/8% debentures were issued limits the amount of dividends the company can pay out. Our interpretation of Section 4.08 indicates future dividend payments will be restricted to what the company can earn (including any gains on the sale of its assets) and approximately $36 million. In other words, we anticipate UV Industries will have to confront and resolve its long-term debt position before liquidation and distribution of the proceeds goes much further."

tors.[4] (Of course, no one has ever asserted that there was anything sham or fraudulent about the Sharon Steel-UV transaction.)

While debtholders may not find it ideal, there is no inequity in their having to look for their protection to the restrictions—such as the dividend restriction—that have been bargained for in an indenture and to the general legal protections against sham transactions.[5] It is from the specific provisions of the indenture contract alone that debtholders derive those rights that differentiate them from other unsecured creditors.

The Second Circuit clearly erred in proceeding from its own notion of equity to rewrite the contracts by implying covenants and restrictions that could have been included but were not.[6] As the Fifth Circuit in banc said in *Broad v. Rockwell*:

> "It is not the function of a court to rewrite a contract's terms in the process of 'interpretation' to make them accord with the court's sense of equity." *Broad v. Rockwell, supra*, 642 F.2d at 956.

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4 For example, fraudulent conveyance laws prevent an obligor from disposing of its assets for an inadequate return, or, if adequate consideration has been received, from distributing proceeds which are needed to honor the obligor's debts. *See, e.g.*, Uniform Fraudulent Conveyance Act §§ 1-12; N.Y. Debtor & Creditor Law §§ 270-81 (McKinney 1977); *Studly v. Lefrak*, 66 A.D.2d 208, 412, N.Y.S.2d 901 (2d Dep't), *aff'd*, 48 N.Y.2d 954, 401 N.E.2d 187, 425 N.Y.S.2d 65 (1979).

5 In focusing on the alleged inequities that would flow from a literal interpretation, the Second Circuit adopts an approach essentially the same as that followed by the original panel in *Broad v. Rockwell, supra*, 614 F.2d at 429-30. If that panel's opinion had been the last word out of the Fifth Circuit on this subject, there would perhaps be no conflict between circuits for this Court to resolve. But the last word from the Fifth Circuit is its in banc opinion which vacated the panel's decision and which conflicts with the Second Circuit's opinion here.

6 The respondents never meet the argument that the parties could have provided in these Indentures—as is provided in other indentures—that adoption of a plan of voluntary liquidation is a default.

Conclusion

For the reasons set forth above and those contained in petitioners' original petition, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

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Respectfully submitted,

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